IN THE

Supreme Court of the United States

October Term, 1978

No. 78-616

SOUTHERN CALIFORNIA EDISON COMPANY,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,

Appellees.

SOUTHERN CALIFORNIA EDISON COMPANY,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, CLAIRE T. DEDRICK, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,

Appellees.

On Appeal From the Supreme Court of the State of California

JURISDICTIONAL STATEMENT.

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On Appeal From the Supreme Court of the State of California

JURISDICTIONAL STATEMENT.

Southern California Edison Company ("Appellant") appeals from orders of the Supreme Court of the State of California entered on July 19, 1978, denying petitions for rehearing of that Court's decisions filed on June 22, 1978, denying petitions for writs of review.[1]

[1]Under California law decisions of the California Supreme Court denying petitions for writs of review have been considered to be rulings on the merits. *People v. Western Airlines, Inc.*, 42 Cal.2d 621, 630, 268 P.2d 723, 728 (1954).

Those decisions upheld the related Decision Nos. 86794 and 87828 dated December 21, 1976, and September 7, 1977, respectively, of the Public Utilities Commission of the State of California (the "Commission"). Notice of appeal was filed on October 16, 1978. Appellant submits this statement to show that the Supreme Court of the United States has jurisdiction of the appeal and should exercise its jurisdiction to determine the substantial federal questions presented.

Opinion Below.

The decisions of the California Supreme Court of June 22, 1978, are reported at 21 Cal. 3d Official Advance Sheets No. 19 (Minutes, p. 2), and the orders denying rehearing are reported at 22 Cal. 3d Official Advance Sheets No. 22 (Minutes, p. 1). Decision Nos. 86794 and 87828 of the Public Utilities Commission are not officially reported. A copy of each of the foregoing, together with a copy of the notices of appeal, are included in the Appendix.

In addition, the Appendix includes Appellant's Petitions for Rehearing before the Commission, the Commission's decisions denying rehearing, Appellant's Petitions for Writ of Review in the California Supreme Court, Appellant's Reply Brief, and Appellant's Petitions for Rehearing before the California Supreme Court. These documents are included to show that the Appellant timely raised the constitutional issues that are the subject matter of this appeal. Finally, also included in the Appendix are copies of the Internal Revenue Service rulings relating to these matters and Commission Decision No. 84568, dated June 17, 1975, the significance of which will become apparent in the Statement of the Case below.

Jurisdiction.

This appeal is brought to review a final judgment of the California Supreme Court upholding these two integrally related rate decisions of the Commission (Decision Nos. 86794 and 87828) involving the Appellant's rate case filed on June 7, 1974, with the Commission (Application No. 54946). Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(2) (1970). The following decisions hold that Commission orders such as Decision Nos. 86794 and 87828 are "statutes" within the purview of 28 U.S.C. § 1257 (2): *Atchison, Topeka & Santa Fe Railway v. Public Utilities Commission*, 346 U.S. 346, 348 (1953); *Bluefield Waterworks & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 683 (1923); *Lake Erie & Western Railroad Co. v. State Public Utilities Commission*, 249 U.S. 422, 424 (1919).

The Supreme Court of California is the highest court of that state. The validity of each of these integrally related Commission decisions in Appellant's rate case was drawn into question in the California Supreme Court on the ground of being repugnant to the Constitution of the United States, and the California Supreme Court affirmed such statute's validity. Appellant attacked the lawfulness thereof in its Petitions for Rehearing before the Public Utilities Commission, and in its Petition for Writ of Review and thereby timely raised such issues for consideration by the Commission and by the California Supreme Court. Cal. Pub. Util. Code § 1732 (West 1975); *Southern Pacific Transportation Co. v. Public Utilities Commission*, 18 Cal. 3d 308, 311-12 fn. 2, 556 P.2d 289, 290-91 fn. 2, 134 Cal.Rptr. 189, 190-91 fn. 2 (1976).

If for any reason appeal is not considered the proper mode of review, Appellant requests that the papers upon which this appeal is taken be regarded and acted upon as a petition for writ of certiorari pursuant to 28 U.S.C. §§ 1257(3) (1970).

Statutes Involved.

The statutes which are the subject of this appeal are the Commission's decision of December 21, 1976, as clarified and affirmed by its decision of September 7, 1977, namely Commission Decision Nos. 86794 and 87828 dated December 21, 1976, and September 7, 1977, respectively, included in the Appendix. The entire decisions are lengthy and for that reason are not set forth here in full. The particular portions of the conclusions in the Decisions involved in this case are as follows:

1. "This return on capital [the allowed rate of return of 8.8%] is the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison." (Dec. No. 86794, p. 23; Appendix p. 21.)
2. "In either case [referring to the IRS information letters to the City of Dallas and New Mexico Public Service Commission—Appendix pp. 296 and 301, respectively] the inclusion of unamortized ITC in common equity at a return on equity less than that applied to the common shareholder's equity rate would dilute the indicated revenue requirement relative to such a requirement exclusive of the unamortized ITC. It is just such an effect the restrictions were intended to contravene. Such restrictions, however, are completely inapplicable for the regulation of utilities subject to this Commission's jurisdiction because rate base is neither adjusted by unamortized ITC nor affected by the utility's capital structure. The unamortized ITC does, however, serve as a source of internal financing and will, therefore, eventually find its way into rate base in the form of capital additions." (Dec. No. 87828, pp. 12 and 13; Appendix pp. 126 and 127).
3. "The inclusion of the effects of Edison's election of Option 2 as one of the many factors considered in our determination of a reasonable rate of return will not adversely affect Edison's eligibility for the additional ITC provided for in the TRA of 1975." (Dec. No. 87828, p. 19; Appendix p. 134).
4. "It is ordered that Decision No. 86794 is affirmed." (Dec. No. 87828, p. 20; Appendix p. 135).

Questions Presented.

1. Do decisions of the United States Supreme Court, including *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944), and *Bluefield Waterworks & Improvement Company v. West Virginia Public Service Commission*, 262 U.S. 679 (1923), which were relied upon by the Commission, *preclude* a state regulatory commission from setting an allowed rate of return at a level higher than the minimum required to avoid confiscation?

2. Whether a state regulatory commission, which has ordered utility rates designed to produce only the minimum revenue (return) required by law and which,

in so doing, has arbitrarily and unjustly disregarded certain costs and assumed, contrary to existing federal precedential rulings, the existence of a tax credit (without which the rates would produce less than the minimum return required by law), has violated the rights of the utility and its shareholders under the federal constitution by depriving them of property without due process of law and by denying an opportunity to earn a reasonable return. (U.S. Const. amend. XIV.)

Statement of the Case.

A. Background Proceedings.

Appellant is a public utility engaged in the production, transmission and distribution of electric energy. Its retail rates are regulated by the Commission. The Decision of which Appellant seeks review arose in the following manner:

1. On June 7, 1974, Appellant filed Application No. 54946 with the Commission requesting authority to increase its rates applicable to retail electric utility service in the State of California by an amount which would produce an estimated increase in revenues based upon test year 1976 of approximately $339 million.

2. On May 13, 1975, the Commission instituted an investigation regarding the investment credit provisions of the Tax Reduction Act of 1975[2] (on less than 10 days' notice because the utilities' election under the Act had to be made by June 26, 1975) and then on June 17, 1975, ordered the investigation discontinued because the Commission was not able to agree on a result.[3]

[2]P.L. 94-12.

[3]Case No. 9915, Dec. No. 84568; Appendix p. 260.

3. On June 25, 1975, Appellant elected Option No. 2, ratable flow-through[4] of the increase in ITC benefits under the Tax Reduction Act of 1975.

4. After full public hearings in connection with Application No. 54946, the Commission on December 21, 1976, issued Decision No. 86794 which (together with the partial general rate increase authorized December 30, 1975, by the Commission as an initial phase but not as final disposition of the matter—Decision No. 85294) authorized an aggregate increase in Edison's base rates amounting to approximately $122 million in annual revenue effect. In rendering Decision No. 86794, the Commission approved rates predicated upon Commission adopted estimates of sales and revenues, expenses and rate base together with a rate of return determined by the Commission to be the minimum required, under the standards it stated were defined by this Court in the *Hope* and *Bluefield* cases, for the test year 1976, *i.e.*, to enable the Appellant to attract capital at a reasonable cost and not to impair its credit.

5. After Decision No. 86794 was issued, the Commission held further hearings to receive evidence among other things upon the issues relating to the investment tax credit ("ITC") and rate of return which the Commission had reopened the proceedings to hear pursuant to Section 1708 of the Public Utilities Code of the State of California.

6. After six days of additional hearings on those issues, and filing of briefs, the Commission issued, on September 7, 1977, its Decision No. 87828 which,

[4]Based on book life of plant which generated the credit (Section 46(f)(6), I.R.C.).

after clarifying what actions it had taken in Decision No. 86794 with regard to the derivation of the rate of return authorized by said decision (varying interpretations had been given by parties to the proceeding to those portions of Decision No. 86794), affirmed the said Decision No. 86794. (Dec. No. 87828; Appendix p. 135.)

7. Following the decisions of the Commission in said rate Application No. 54946, timely petitions for rehearing were made to the Commission (Appendix pp. 149 and 180) and were denied. (Appendix pp. 178-180.) Thereafter, petitions for writ of review were timely made to the California Supreme Court (Appendix pp. 182 and 204) and were denied by that Court on June 22, 1978 (Appendix pp. 278-279). Petitions for rehearing by the California Supreme Court were timely filed on July 7, 1978 (Appendix p. 250), and were subsequently denied by the Court on July 19, 1978 (Appendix pp. 280-281).

B. Undisputed Facts.

In the case at bar involving the aforesaid dockets, the following facts are indisputable from the record:

1. The Commission in setting the rate of return allowed to Edison in the case at bar relied upon its conception of the standard set by this Court in two cases; the Commission stated:

> "The United States Supreme Court has broadly defined the revenue requirements of utility companies as being the minimum amount which will enable the Company to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed (*Federal Power Commission, et al. v. The Hope Natural Gas Company* (1944) 320 US 591, 605; 88 L. ed 333, 346) and will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties (*Bluefield Waterworks and Improvement Company v West Virginia Public Service Commission* (1923) 262 U.S. 679, 692, 693; 67 L. ed at 1176)." (Dec. No. 86794 at p. 7; Appendix p. 5.)

2. Whether because of a misconception of such decisions of this Court[5] or otherwise, the Commission stated in its decision that the rate of return which it was authorizing was one which it determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison" (Dec. No. 86794, p. 23; Appendix p. 21). *Cf. Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 605 (1944); and *Bluefield Waterworks & Improvement Company of West Virginia v. West Virginia Public Service Commission*, 262 U.S. 679, 692-93 (1923).

3. In adopting such minimum revenue requirement basis for fixing Edison's rates, it is indisputable that the Commission assumed in its decision that the increase in Investment Tax Credit ("ITC") provided by the Tax Reduction Act of 1975 would be available to Appellant as a credit and such credit was taken into account in determining its revenue requirements and

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[5]See Reply Brief of Petitioner to Answer of Respondent, Docket Nos. S. F. 23605 and 23723, p. 2, *et seq.* (Appendix p. 230).

as a source of capital. (Dec. No. 86794, pp. 64-68; Appendix pp. 61-67; Dec. No. 87828, Findings 1 and 2, p. 18, and Conclusion 1, p. 19; Appendix pp. 133-135.)

4. If, contrary to the Commission's assumption, such ITC credits are not to be available to Appellant, it necessarily follows that the authorized rates and rate of return (which were designed upon the assumption of the continued availability of such credits) would not be designed to produce even the minimum revenue which the Commission determined to be required by law and would, at least to that extent, be confiscatory and thus unlawful.

5. As fully disclosed in Appellant's petitions below (Appendix pp. 225-226), after the clarifying decision by the Commission (Dec. No. 87828), Appellant sought a revenue ruling from the Internal Revenue Service (IRS), concerning its eligibility for the additional ITC (by letter dated September 22, 1977, which was in a form that the California Commission had had an opportunity to review before it was filed). As of the date of the preparation of our jurisdictional statement, the IRS has not ruled upon the question,[6] and, while Appellant hopes to obtain a favorable ruling, in light of the clarifications by the Commission in Decision No. 87828, and the differences believed to exist between the factual situations in this case and in those cases involving other California utilities where unfavorable IRS rulings were issued,[7] Appellant would suffer irrep-

[6]Appellant intends to promptly advise the Court of the receipt of any such ruling and submit a copy thereof.

[7]*E.g.*, Ex. 125 Southern California Gas Company Ruling (T:C:E:A:3; Appendix p. 282). *Cf.* IRS information letters (Appendix pp. 296 and 301).

arable damage should a similarly negative IRS ruling be issued with respect to its request. In all cases to date, of which we are aware, in which the IRS has issued rulings concerning rate actions taken by the Commission involving other California utilities, the IRS has concluded that the ITC eligibility would be lost because of rate treatment applied to such federal income tax benefits by the Commission.[8]

The amounts involved are substantial, running into many millions of dollars,[9] and the loss of such additional ITC benefits could adversely impact not only Appellant's ratepayers and customers but its employees as well because of the TRASOP aspects of the matter.[10]

6. The Commission itself has recognized that continued eligibility for investment tax credit is in the public interest. For example, it stated in its Decision No. 87838 (on pp. 19-20) involving Pacific Telephone and Telegraph Company that:

> "Eligibility is the first issue to be determined. To render a decision which attempts to resolve

[8]We are advised that four more such rulings have been issued by the IRS subsequent to the close of the record in this case involving California telephone utilities and indicating loss of eligibility for tax benefits and that they have been included in Docket Nos. 78-606 and 78-607, App. D, pp. 95A and 116A, and App. E, p. 133A filed with the Court.

[9]The evidence in Appl. No. 54946 indicates that for Appellant loss of eligibility would result in a lost tax credit for the years 1975 and 1976 involving approximately $16 million and an estimated loss through 1980 in excess of an additional $138 million (exclusive of the loss of Tax Reduction Act Stock Ownership Plan (TRASOP) benefits, which result from the additional 1% tax credit under the Tax Reduction Act of 1975). Reenders, Ex. 130, p. 5; Ex. 131, Table 1; Appendix p. 226.

[10]Loss of eligibility would also involve possibility of loss of benefits to employees under TRASOP. Appendix p. 226.

these cases without regard for this issue might create problems for these utilities, their ratepayers, the Commission, and the Courts that exceed (both in scope and complexity) the problems that we are attempting to resolve in this decision. In the final analysis a loss of eligibility to the utilities would not only create service problems (though certainly not of the scope described by the Pacific's [sic]) but would create staggering financial problems to be ultimately borne by the ratepayers whose interest we are attempting to redress. We believe that eligibility for these tax benefits should be retained and proceed on that basis."

7. In fixing a rate of return which the Commission determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison", it made no adjustment to allow for the fact that the new rates being authorized by its decision would not be effective until *after* the end of the test year 1976 and excluded from rate base, to which such rate of return was applied, investment in certain plant items which were in service by the end of the test year.

8. The rates fixed by the Commission for Appellant have not been designed to enable it to sell new issues of its common stock except at prices significantly ***below*** book value with the resultant dilution of the equity interest of its existing common stockholders. To illustrate at page 20 of Decision No. 86794 (Appendix p. 19) the Commission recognized that the record indicated that a return on common equity of at least 13.28% would be required to raise market price to book value yet it allowed only 12.63%; the Appellant

issued 5,000,000 shares of common stock in 1976 which was marketed at $21.455 per share when the book value was $32.85.

The Rates Fixed by the Commission for Appellant Improperly Apply the Tests for an Adequate Rate Prescribed by the United States Supreme Court and Deny It the Opportunity to Earn an Adequate Rate of Return in Violation of Its Constitutional Rights.

A. The Commission Incorrectly Applied the Standards for Utility Ratemaking Established by the United States Supreme Court in a Number of Respects.

1. The Commission's Decision No. 86794 indicated that the Commission, while citing the decisions of this Court in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 615 (1944), and *Bluefield Waterworks & Improvement Co. v. West Virginia Public Service Commission*, 262 U.S. 679, 692-93 (1923), was operating under the misconception, in fixing Appellant's rates, that such decisions *precluded* the Commission, in the exercise of its jurisdiction, from authorizing rates which would be higher than the minimum amount required to enable Appellant to operate successfully, to maintain its financial integrity, and to compensate its investors for risks assumed (see Dec. No. 86794, *mimeo* p. 7; Appendix p. 5).[11] This is a demonstrably erroneous regulatory standard or limitation upon a regulatory commission's authority that is not required by the decisions of this Court relied upon by the Commission or by any other decisions of this Court.

a. While such decisions establish, as a *constitutional* matter, that rates which do not meet such minimum

[11]See quotation on pp. 8-9, *supra*.

standards are unlawful, there is nothing in said decisions to suggest that a regulatory commission, in carrying out its responsibilities to fix just and reasonable rates, cannot lawfully set rates at a higher level than such constitutional minimum where it is persuaded that the conditions justify it. To the contrary, this Court stated, in *Mobil Oil Corp. v. Federal Power Commission,* 417 U.S. 283, 317, ". . . we have emphasized that the courts are without authority to set aside any rate adopted by the commission which is within a 'zone of reasonableness.' . . ." (quoting *Permian Basin Area Rate Cases,* 390 U.S. 747, 797 (1968)). There are numerous cases, including earlier decisions of the California Commission, where the setting of rates higher than the minimum, within such zone of reasonableness, has been deemed appropriate and lawful (*e.g., Banton v. Belt Line Railway Corp.,* 268 U.S. 413, 422-24 (1925); *Pacific Telephone and Telegraph Co. v. Public Utilities Commission,* 34 Cal. 2d 822, 829, 215 P.2d 441, 445 (1950); *Southern California Edison Co.,* 72 CPUC 282, 289 (1971)). It is a matter of economic fact that, in periods of continuing inflation, unless general rate applications are to be filed by the utility and processed by the regulating commission on an annual basis, rates must necessarily be fixed on the basis of revenue requirements above the minimum required based on test year cost of service or the utility will be effectively denied the opportunity to earn (in the period subsequent to the test year) the minimum earnings determined by the Commission to be required.[12]

[12]*Cf. New England Telephone & Telegraph Co. v. Massachusetts Dept. of Public Utilities,* 354 N.E.2d 860, 864-68, 16 PUR 4th 346, at 349-50.

b. Inasmuch as the Commission's Legal Staff, in an answer subsequently filed on behalf of the Commission with the California Supreme Court, stated it "admits, as it must, that neither *Hope* nor *Bluefield* require that the 'minimum' rate of return found to be reasonable must be the one adopted," it must be pointed out that this issue was raised in Edison's petition for rehearing dated January 7, 1977,[13] and that the Commission, as distinguished from its Legal Staff, neither granted rehearing on that issue nor clarified, nor corrected, nor denied that it had felt itself legally required, in issuing its Decision No. 86794, to fix utility rates at such minimum, nor denied that it had applied such an improper standard.[14]

c. The rate of return to be allowed by a regulatory commission in any particular rate proceeding normally falls within a range of reasonableness, and that rate of return which is the minimum necessary to avoid unconstitutional confiscation would obviously not exceed the bottom of that range (*cf. New England Telephone & Telegraph Co. v. Department of Public Utilities,* 354 N.E.2d 860, 868 (Mass. 1976)).

2. In addition, in fixing Appellant's rates in these proceedings, the Commission also failed in other respects properly to apply the tests for an adequate rate of return laid down in the *Hope* and *Bluefield* cases.

a. It is respectfully submitted that when a utility is denied the opportunity, as in this case, to earn

[13]See "Petition of Southern California Edison Company for Rehearing of Decision No. 86794 or for Reconsideration and Modification Thereof" dated January 7, 1977, pp. 1-3; Appendix p. 149.

[14]Dec. No. 86986, dated February 15, 1977, denying rehearing as to this issue. Appendix p. 175.

a return which would avoid continued dilution of existing shareholders' interests, by precluding the necessity of issuing additional common stock below book value, the tests of the aforesaid cases as to the adequacy of the return allowance have not been met. To state the matter in another way, a rate which assures continued dilution of existing shareholders' interests does not enable the utility to attract capital on reasonable terms and does not avoid impairment of the utility's credit. Thus it cannot be considered adequate under *Hope* and *Bluefield*.

b. The *Hope* and *Bluefield* decisions of this Court have laid down the tests of the adequacy of the rates authorized in the following terms: the rates must afford the utility a reasonable opportunity to realize earnings which (1) must be comparable to earnings on investments of similar risk, (2) must be such as not to impair the credit of the utility, and (3) must enable the utility to attract new capital. (See: 262 U.S. 679, 693; 320 U.S. 591, 603.)

c. It is demonstrable that the Commission's decisions in these proceedings fail to meet these tests.

(1) The Commission's adoption of a 12.63 percent return on common equity, for the purpose of determining the minimum required rate of return which it used in fixing rates, is grossly inadequate to permit Appellant's common stock to be issued to yield net proceeds approximating book value. This is clearly indicated not only by the recognized record showing that a return on common equity of at least 13.28% would be required to raise market price to book value (Decision No. 86794, p. 20; Appendix p. 19) but also by Appellant's experience after the partial general increase authorized by Decision No. 85294 on December

30, 1975 (after which Appellant's common stock throughout 1976 continued well below book value, never reaching as high as $24.00 per share although the book value as far back as December 31, 1973, was over $28.00).[15] Since the issuance of its Decision No. 86794 Appellant's common stock has continued to sell well below book. It is, of course, fundamental that if new stock yields net proceeds less than book value, the equity of existing shareholders is subjected to forced dilution (*cf. New England Telephone & Telegraph Co. v. Department of Public Utilities*, 354 N.E.2d 860, 865-67 (Mass. 1976)).

(2) That Appellant has been denied the opportunity to realize earnings comparable to those on investments involving similar risks, is indicated by the fact that the stock of Appellant has continued to sell substantially below book (more than 20 percent below book value), while those of most other similar electric utilities in the country have been selling at prices which approach or exceed book value.

B. Having Set the Authorized Rate of Return at the Minimum Found by the Commission to Be Necessary, the Commission Then, by Its Decisions, Arbitrarily and Unlawfully Produced Results Which Precluded Appellant From Any Opportunity to Earn Even Such Minimum for the Test Year.

1. It is respectfully submitted that it cannot be reasonably concluded that there has not been an unlawful confiscation where a state regulatory commission

[15]Even such increase to book value would be insufficient to enable new stock to be issued without forced dilution since selling costs and market pressure resulting from a new issue would result in net proceeds per share being below book value. Edison issued 500,000 shares of additional common stock in 1976 at a net proceeds of $21.455 per share when the book value per share was about $32.85 resulting in a dilution of existing shareholders interest amounting to about 3.3%.

had ordered utility rates designed to produce only the *minimum* return required by law and in so doing had erroneously assumed the existence of a tax credit to operating expenses without which the rates so fixed would produce less than the minimum return required by law. The logic supportive of such belief may be set forth in syllogistic form as follows:

Major Premise: Anything below the minimum required by law is confiscatory.

Minor Premise: Rates here were designed to produce, *with* the assumed availability to Appellant of the increase in the Investment Tax Credit under the Tax Reduction Act of 1975, the minimum required by law.

Conclusion: *Without* the assumed benefit of the increase in the Investment Tax Credit, the rates designed here would be below such minimum and would thus be confiscatory.

2. That the Commission, in its determination of Appellant's minimum revenue requirements for test year 1976 in the case at bar, assumed that Appellant would be eligible for the additional Investment Tax Credit benefits provided by the Tax Reduction Act of 1975, as extended by the Tax Reform Act of 1976, is manifestly clear from the following portions of the Decisions appealed from:

(a) "Another factor for consideration in arriving at the proper rate of return level is the additional investment tax credit benefits accruing to Edison as a result of the Tax Reduction Act of 1975 (TRA). The record shows that Edison elected Option 2, ratable flow-through, for the additional 6 percent investment tax credit provided for by TRA." (Dec. No. 86794, p. 22; Appendix p. 20.)

(b) "After careful consideration of all the previously discussed relevant factors in the development of a reasonable return on common equity we adopt as reasonable a return on equity of 12.63 percent which, applied to our adopted capital structure and costs, translates to a rate of return of 8.8 percent developed as follows:

	Capital Ratio	*Cost Factor*	*Weighted Cost*
Long Term Debt	49.95	6.51	3.25
Preferred & Preference Stock	13.63	6.94	.95
Common Equity	36.42	12.63	4.60
Total	100.00	—	8.80

"This return on capital is the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison. This rate of return will provide an approximate times interest coverage after income taxes of 2.71 times and an interest plus preferred dividend coverage of 2.09 times. Relating this 8.8 percent rate of return to our subsequently discussed adopted summary of earnings for Edison's California jurisdictional operations results in a gross revenue increase of approximately $122.5 million over the rates authorized by Decision No. 81919,[16] or $44.5 million over the rates authorized by Decision No. 85294.[17]" (Dec. No. 86794, p. 23; Appendix pp. 20-21.) (Footnotes added.)

[16]The final decision in Appellant's most recent prior general rate case.

[17]The decision granting a partial increase in Appl. No. 54946.

(c) "TRA, signed into law by the President on March 29, 1975, provides, among other things, for an increase in the investment tax credit rate from four percent to 10 percent (seven percent for certain transmission lines for new qualified plant expenditures made subsequent to January 21, 1975 and before January 1, 1977, when the investment tax credit reverts back to the previous rate.

"TRA further provides that those utilities, such as Edison, that use flow-through accounting for tax depreciation may elect, by June 26, 1975, one of the following three options . . . Option 2-credit income with the amortization of investment credit over the life of the property (ratable flow-through) . . . On June 25, 1975 Edison elected Option 2-ratable flow-through.

"TRA also provides that the additional ITC benefits shall not apply if the taxpayer's cost of service for ratemaking purposes is reduced by more than a ratable portion of the allowable credit or if the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the allowable credit." (Dec. No. 86794, pp. 63-65; Appendix pp. 62-63.)

(d) "The inclusion of the effects of Edison's election of Option 2 as one of the many factors considered in our determination of a reasonable return will not adversely affect Edison's eligibility for the additional ITC provided for in the TRA of 1975." (Dec. No. 87828, p. 19; Appendix p. 134.)

3. The general approach employed by the Commission for determining what constitutes permissible rates is to determine with respect to a "test period" (1) the rate base (investment) of the utility, (2) gross operating revenues under existing rates, (3) operating costs and expenses allowed for ratemaking purposes, and (4) the net revenues or return on investment produced thereby. Then by determining the rate of return to be fixed or allowed upon its rate base measured by the utility's cost of capital and comparing the net revenue (return on rate base) which would be earned under existing rates with the net revenue (return) required for the test period based on the cost of capital, the Commission determines how much the utility's rates and charges should be raised or lowered (*cf. Pacific Telephone & Telegraph v. Public Utilities Commission*, 62 Cal. 2d 634, 644-45, 401 P.2d 353, 359, 44 Cal. Rptr. 1, 7 (1965)). Under such a procedure, an increase in a cost or operating expense item will result in an increase in the revenue requirement needed to be covered by rates and similarly the loss of or a decrease in a credit to an operating expense or cost item also results in an increase in the revenue requirement (*cf. City and County of San Francisco v. Public Utilities Commission*, 6 Cal. 3d 119, 122-23, 490 P.2d 798, 799, 98 Cal. Rptr. 286, 287 (1971)).

Thus, when rates are fixed under an erroneous assumption as to the availability of revenue at existing rates or credit to an operating expense item, they produce less net revenues (return) than they were designed to produce. It follows that, if rates are fixed at the *minimum* level required by law to meet the

constitutional earnings tests of *Bluefield* and *Hope*, and if such rates are based upon an erroneous assumption as to the availability of an income tax credit item, then the rates so authorized will not produce the minimum revenue requirement and they are confiscatory. (See *Board of Public Utility Commission v. New York Telephone Co.*, 271 U.S. 23, 31 (1926).

In the case at bar, if the experience of Appellant proves to be similar to the experience of Southern California Gas Company, Pacific Telephone & Telegraph Company and General Telephone Company (that the actions taken by the Commission in the rate Decisions appealed from are ruled by the IRS to render it ineligible for the income tax benefits), such tax benefits being assumed by the Commission to be available to Appellant in fixing its rates at the minimum level required by law, Appellant would incur irreparable damage. This follows because under the proscriptions against retroactive ratemaking and under the historically established principles of constitutional law, the Commission could not in the future properly make Appellant whole by increasing future rates higher than they should otherwise be, because of such past losses. Past losses cannot be used to enhance the value of the property or support a claim that rates for the future are confiscatory (*see, Board of Public Utility Commission v. New York Telephone Co.*, 271 U.S. 23 (1926); *Georgia Railway & Power Company v. Railroad Commission*, 262 U.S. 625 (1923); *Galveston Electric Co. v. Galveston*, 258 U.S. 388, 395 (1922); *Pacific Telephone & Telegraph v. Public Utilities Commission*, 62 Cal. 2d 634, 401 P.2d 353, 359, 44 Cal. Rptr. 1, 7 (1965)).

It has been judicially recognized that a commission's placing of a utility in such jeopardy with regards to

eligibility for tax credits is an unreasonable exercise of power and abuse of discretion. See: *New England Telephone & Telegraph Co. v. Public Utilities Commission*, Slip Op., pp. 12-36 (Maine S. Ct., June 28, 1978) Division No. 752, CCH Utilities Law Reports—State, 7-21-78 Par. 22596.03 where the court, in reversing and remanding a Maine Commission decision concerning, among other things, the Commission fixing of rates in an manner jeopardizing the eligibility of a telephone utility for accelerated depreciation for tax purposes, stated (at pp. 35-36):

> "We find there is reasonable likelihood that New England would lose its ability to take accelerated depreciation or, at least, be subject to federal action with respect thereto. The effect of the Commission decree, if sustained by the Court, would be, at least, to place New England in jeopardy of losing its ability to take accelerated depreciation for federal income tax purposes.
>
> "The Commission treatment of accelerated depreciation in this case was to act directly contrary to the national economic policy set by the Congress of the United States. No reasonable justification for the action taken can be found in the record.
>
> "In conclusion, we find that the Commission's action with respect to the accelerated depreciation issue constitutes an unreasonable exercise of power and abuse of discretion for two reasons. First, it *arbitrarily* disregarded the normalization method of accounting, which it had ordered New England to follow. Second, it arbitrarily placed New England in jeopardy of losing its ability to take accelerated depreciation."

4. In addition, since the new rates here involved did not become effective until after the 1976 test year, Appellant could not possibly earn the authorized minimum rate of return. In establishing a rate of return which it determined to be "the minimum needed to attract capital at a reasonable cost and not impair the credit of Edison," the Commission made no adjustment therein to allow for the fact that the new rates here involved would not be effective until *after* the end of the test year (Appendix p. 150); the result is an obvious inability, under such circumstances, due to earnings attrition as a result of continuing inflation, of Appellant to earn the rate of return the Commission deemed to be the minimum required. It is manifestly clear that the return which the Commission finds to be the "minimum needed to attract capital at a reasonable cost and not impair the credit of Edison" cannot be earned utilizing rates, based upon such rate of return, which will not be effective until some time after the end of the test period 1976.

5. Furthermore, the Commission arbitrarily refused to include in rate base plant items which the uncontroverted record showed did not contribute to increased capacity of the system, and therefore are not, when operational, associated with increased load or sales. Because such plant became operational before the rate increases authorized by the Decision were to be effective and the allowance for funds on such investment (ADC) terminated prior to such rate increases becoming effective, the Commission's action unreasonably and erroneously denied the utility an opportunity to earn upon such plant devoted to a public use. The exclusion of such items from rate base and the resulting prevention of any opportunity to earn upon such plant

devoted to a public use violates Appellant's constitutional rights and is a denial of due process of law (Appendix p. 151, *et seq.*).

6. Nor can the Commission under the constitutional standards prescribed by this Court in the *Hope* and *Bluefield* cases properly fix rates which are not reasonably designed to provide the utility with an opportunity to earn a return that will avoid continuing dilution of the interests of the common stockholder because the earnings realistically contemplated are insufficient to support the sale of new common stock at prices at least approximating book value. In a case involving a situation which, in this respect, is substantially on all fours with the case at bar, the Supreme Judicial Court of Massachusetts recognized the constitutional inhibitions upon such action in *New England Telephone & Telegraph Co. v. Department of Public Utilities,* 354 N.E.2d 860, 868 (Mass. 1976).

The Questions Involved Are Substantial and Have Far Reaching Effects.

A. Any application by the California Commission of the misconception that the decisions of this Court require that utility rates be fixed by a state regulatory commission at no more than the minimum level required to avoid confiscation, and that such state regulatory bodies are precluded from allowing higher rates within a zone of reasonableness, would obviously adversely affect investor attitude with respect to investing in such utilities and thus would have far reaching and disastrous effects upon the ability of the utility industry to raise the enormous amounts of additional capital required to build the facilities needed to provide adequate public utility service in the future.

B. Loss to Appellant of eligibility for investment tax credit benefits because of regulatory action, or for any reason, would result in substantial irreparable harm. The loss of such investment tax credit benefits alone would result in approximately $150 million of tax increase to Appellant for the period 1975 through 1980 and result in the confiscation of property of Appellant and its shareholders of over $3 million during the period, aside from the dilutive effect on existing shareholder interests of issuing new common stock at prices below book value, and would preclude tax benefits amounting to more than $300 million being ratably flowed through to Appellant's ratepayers over the life of the property giving rise to such tax benefits.

In addition, such disallowance could also result in the loss to the approximately 13,000 Edison employees of some $26 million in Edison stock because of the possibility of loss of eligibility for the additional investment tax credit provided by the federal government under the employee stock ownership plan (known as TRASOP or ESOP) (I.R.C. §46(a)(2)(b)).

Under the provisions of the Internal Revenue Code involved here, Congress has, in effect, granted benefits to be shared by the ratepayers, the shareholders, and utility employees. Such benefits are designed to help finance the construction needs of the utility industry, while at the same time provide the rate relief to ratepayers, and benefits to utility employees. The public interest aspects involved in carrying out the will of the Congress in enacting such federal tax laws and in maintaining eligibility thereunder is manifestly clear. The overriding importance of this matter has not been challenged. The Commission itself has recognized that

the public interest is so served and indicated in the final analysis a loss of eligibity to the utilities would not only create service problems, but would create staggering financial problems to be ultimately borne by the ratepayers.

The tax policies established by the Congress in providing such substantial investment tax credits and benefits in the federal tax laws should, we respectfully submit, not be permitted by this Honorable Court to be thwarted by a clash or controversy between the state regulatory commission and the Internal Revenue Service over the appropriate standards of eligibility under the federal tax laws.

Conclusion.

Based upon the foregoing, and the substantial federal questions raised therein, Appellant respectfully submits that this Court should assert jurisdiction in this case.

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